

# FDIC State Profile

SUMMER 2003

## Puerto Rico and the U.S. Virgin Islands

The Puerto Rico economy contracted more sharply than the nation during the recent recession. However, the rate of job loss eased in the first quarter 2003, and unemployment rates may have peaked. The U.S. Virgin Island's economy has lagged the U.S. since 2002.

- Puerto Rico's economy shows signs of stabilizing. In first quarter 2003, Puerto Rico's unemployment rate was 11.9 percent, down from over 13 percent in 2002. The rate of unemployment has been historically higher in Puerto Rico than in the U.S., resulting from structural unemployment conditions persisting in Puerto Rico (chart 1).
- Manufacturing is Puerto Rico's dominant economic sector, accounting for 40 percent of its gross product, more than double the 16 percent share for the U.S. economy. In 2002, employment in Puerto Rico's manufacturing sector fell 8.5 percent, compared with a 6.9 percent decline in the U.S. Some of the decline may be attributable to the lack of demand from the U.S. mainland. The phase out of section 936 of the U.S. tax code and the implementation of trade liberalization policies have also been cited as contributors to manufacturing job losses.
- Employment in Puerto Rico's construction sector, which represents 7 percent of total employment compared with 5 percent in the nation, has trended downward during the past two years. After increasing during the 1990s, the dollar value of private construction activity has leveled off, while public construction has declined (chart 2).
- Office vacancy rates in Puerto Rico have been rising and supply is expected to increase. According to reports, one million square feet of new office space has been added in San Juan over the past 18 months and an additional 1.7 million square feet of new space is scheduled to be completed during the next 18 months. Developers are concerned about the potential for a glut in office space because the market typically absorbs only 200,000 square feet of office space each year.
- The economic slowdown and the Iraqi war have had a negative impact upon Puerto Rico's tourism industry. The World Travel and Tourism Council estimate that the war cost Puerto Rico \$262 million in lost revenue and 3,800 jobs.
- The U.S. Virgin Islands' employment growth stabilized in 2002, after declining sharply the prior year as tourism waned (chart 3). Tourism is the USVI's dominant industry, representing 70 percent of gross product. One large

Chart 1: Relative to the U.S., Unemployment Rates in Puerto Rico Have Slightly Declined

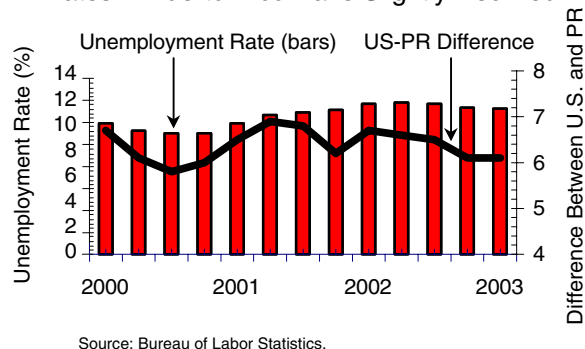


Chart 2: Construction Spending Has Levelled off in Puerto Rico

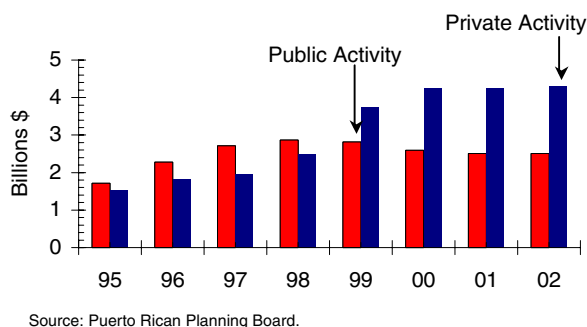
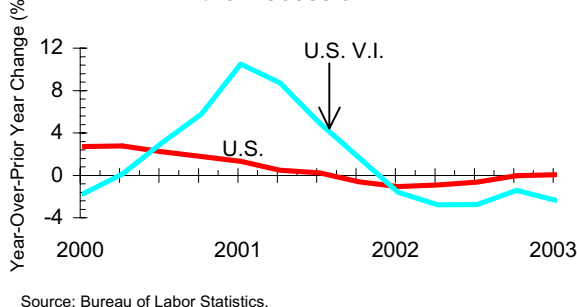


Chart 3: USVI Employment Growth Has Sharply Turned Negative After Holding Up Well During the Recession



employer, Hovensa (an oil refinery), is undergoing an expansion project.

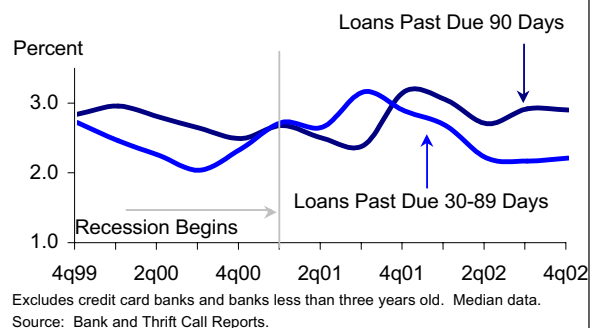
**Credit quality among insured institutions headquartered in Puerto Rico/U.S. Virgin Islands (PRVI) weakened moderately at the start of the recession, but has recently appeared to have stabilized.<sup>1</sup>**

- Loan delinquency rates among insured institutions headquartered in PRVI slightly increased since the start of the U.S. recession, but showed signs of stabilizing. The ratio of loans 30-89 days delinquent to total loans leveled off at year-end 2002 (chart 4). Historically, past-due and charge-off ratios among banks headquartered in the area have exceeded mainland levels.
- Delinquency rates on consumer and residential real estate loans increased since the start of the economic downturn, but have shown recent improvement. Nonetheless, weak employment conditions in key industries could have a lagged effect on consumer loan quality.
- The delinquency rate on commercial and industrial (C&I) loans has stabilized after increasing during 2002, but remains above levels of the late 1990s. The median ratio of commercial real estate (CRE) loans delinquent also has increased over the past year (chart 5). The prolonged national economic weakness and increased CRE supply, however, could place pressure on loan credit quality during 2003.
- Median net interest margin of institutions headquartered in PRVI declined during 2002 as market interest rates reached historic lows. Due to the highly competitive banking market, relatively large unbanked population (estimates indicate that as much as 50 percent of Puerto Rican citizens do not have bank accounts), and tax-advantaged alternatives to bank deposits, raising low-cost deposits locally tends to be challenging in Puerto Rico.

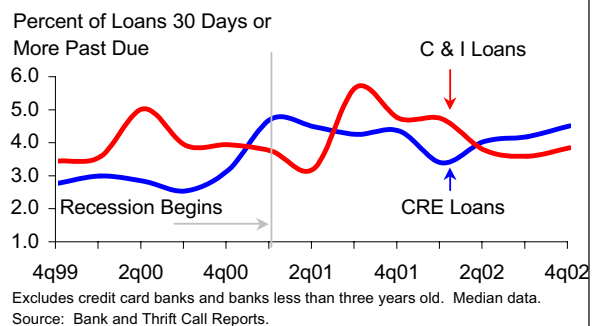
**Exposure to traditionally higher-risk loans remains high among insured institutions headquartered in PRVI.**

- Consistent with national trends, the percentage of insured institutions with concentrations of traditionally higher-risk loans of at least 300 percent of capital headquartered in PRVI increased during the 1990s economic expansion. While the percentage has moderated in recent years, at 69 percent it remains above the national level of 49 percent (chart 6).

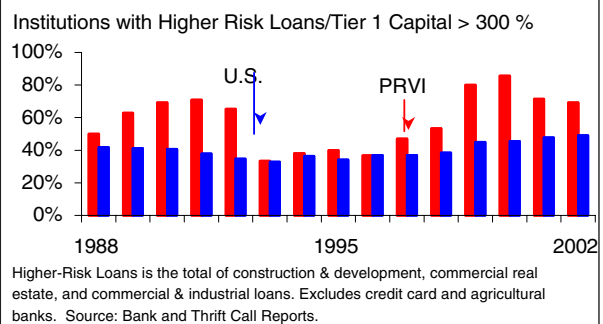
**Chart 4: Loan Quality Among Insured Institutions in Puerto Rico/USVI Has Stabilized**



**Chart 5: Commercial Loan Quality Weakened Moderately in Puerto Rico/USVI During Recession**



**Chart 6: Exposure to Traditionally Higher-Risk Loans in PRVI Remains Above the National Level**



- As credit quality typically lags the business cycle, given these concentrations, loan performance likely will remain weak in coming quarters even if the economic recovery strengthens.

<sup>1</sup> Analysis includes 13 insured institutions headquartered in Puerto Rico and the U.S. Virgin Islands as of December 31, 2002.

## State Profile

### Puerto Rico & U.S. Virgin Islands at a Glance

General Information	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Institutions (#)	13	14	14	15	15
Total Assets (in thousands)	67,165,698	59,615,354	52,407,582	46,316,896	41,563,958
New Institutions (# < 3 years)	0	1	1	1	0
New Institutions (# < 9 years)	3	3	3	3	2
Capital	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Tier 1 Leverage (median)	6.79	6.42	6.30	7.07	7.20
Asset Quality	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Past-Due and Nonaccrual (median %)	5.26%	5.95%	4.80%	5.49%	6.39%
Past-Due and Nonaccrual >= 5%	8	10	5	10	10
ALLL/Total Loans (median %)	1.24%	1.26%	1.22%	1.33%	1.40%
ALLL/Noncurrent Loans (median multiple)	0.40	0.45	0.55	0.58	0.45
Net Loan Losses/Loans (aggregate)	0.89%	1.00%	0.94%	0.88%	1.13%
Earnings	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Unprofitable Institutions (#)	1	1	1	2	1
Percent Unprofitable	7.69%	7.14%	7.14%	13.33%	6.67%
Return on Assets (median %)	1.20	1.14	1.01	1.05	1.12
25th Percentile	0.36	0.64	0.67	0.69	0.76
Net Interest Margin (median %)	3.24%	3.73%	3.78%	4.39%	4.71%
Yield on Earning Assets (median)	6.48%	7.77%	8.73%	8.16%	8.53%
Cost of Funding Earning Assets (median)	3.19%	4.31%	5.26%	4.21%	4.38%
Provisions to Avg. Assets (median)	0.53%	0.39%	0.43%	0.46%	0.56%
Noninterest Income to Avg. Assets (median)	0.55%	0.58%	0.63%	0.66%	0.75%
Overhead to Avg. Assets (median)	2.44%	2.41%	2.57%	2.99%	3.25%
Liquidity/Sensitivity	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Loans to Deposits (median %)	91.07%	92.71%	90.72%	87.28%	84.94%
Loans to Assets (median %)	53.24%	58.55%	59.13%	58.52%	58.76%
Brokered Deposits (# of Institutions)	10	11	11	10	10
Bro. Deps./Assets (median for above inst.)	15.72%	10.23%	6.35%	9.10%	6.82%
Noncore Funding to Assets (median)	61.57%	61.87%	62.42%	57.93%	48.71%
Core Funding to Assets (median)	25.48%	29.39%	29.49%	32.61%	43.59%
Bank Class	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
State Nonmember	12	13	13	13	13
National	0	0	0	0	0
State Member	1	1	1	1	1
S&L	0	0	0	0	0
Savings Bank	0	0	0	1	1
Mutually Insured	0	0	0	0	0
MSA Distribution	# of Inst.	Assets	% Inst.	% Assets	
San Juan-Bayamon PR PMSA	10	58,857,397	76.92%	87.63%	
No MSA	2	120,728	15.38%	0.18%	
Mayaguez PR	1	8,187,573	7.69%	12.19%	